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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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GARY PIERCE – Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

AZ CORP COMMISSION
DOCKET CONTROL

Docket No.: G-01551A-10-0458

In the Matter of the Application of Southwest Gas Corporation for the Establishment of Just and Reasonable Rates and Charges Designed to Realize a Reasonable Rate of Return on the Fair Value of the Properties of Southwest Gas Corporation Devoted to its Arizona Operations; Approval of Deferred Accounting Orders; and for Approval of an Energy Efficiency and Renewable Energy Resource Technology Portfolio Implementation Plan.

**POST-HEARING BRIEF OF
SOUTHWEST GAS CORPORATION**

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18 Resource Technology Portfolio
19 Implementation Plan.

Docket No.: G-01551A-10-0458

20 **POST-HEARING BRIEF OF SOUTHWEST GAS CORPORATION**

21 **I.**

22 **INTRODUCTION**

23 Southwest Gas Corporation ("Southwest Gas" or "Company"), hereby submits to the
24 Arizona Corporation Commission ("Commission"), its post-hearing brief in support of the
25 Settlement Agreement¹ agreed upon and executed by a majority of the parties to this
26 docket. The Settlement Agreement resolves, in its entirety, the Company's Application for
27 the Establishment of Just and Reasonable Rates and Charges Designed to Realize a
28 Reasonable Rate of Return on the Fair Value of Properties Devoted to Its Arizona
Operations; Approval of Deferred Accounting Orders; and Approval of an Energy Efficiency
and Renewable Energy Resource Technology Portfolio Implementation Plan ("Application")².

¹ Ex. A-14.

² Ex. A-1.

1 The overall goal of Southwest Gas' Application is to secure the revenue increase
2 necessary to maintain and provide safe and reliable natural gas service to its Arizona
3 customers. However, since the Company's last general rate case decision in 2008, two
4 significant events greatly influenced the Company's Application and the resulting Settlement
5 Agreement. First, the Commission instituted rulemakings to consider the need for increased
6 energy efficiency in Arizona, and to examine ways to protect customers from increasing
7 utility bills. This resulted in the passage of the *Electric and Gas Energy Efficiency Standards*
8 ("EE Rules"). The Commission's EE Rules are likely the most aggressive energy efficiency
9 standards in the nation, requiring natural gas utilities to achieve cumulative annual energy
10 savings of 6% by December 31, 2020.

11 Second, the Commission recognized that sales reductions resulting from energy
12 efficiency programs will significantly impact a utility's ability to recover its Commission-
13 approved fixed costs, thereby creating utility disincentives to promoting energy efficiency
14 and achieving the levels of energy savings required by the EE Rules. The Commission
15 therefore committed to a thorough investigation and evaluation of ways to eliminate such
16 disincentives, including potential changes to the regulatory model under which Arizona
17 utilities operate. Through this process, which included information and input from
18 independent organizations such as Lawrence Berkeley National Laboratories, the
19 Regulatory Assistance Project, Natural Resources Defense Council and Southwest Energy
20 Efficiency Project, the Commission completely vetted various alternatives, resulting in the
21 unanimous approval of the *ACC Policy Statement Regarding Utility Disincentives to Energy*
22 *Efficiency and Decoupled Rate Structures* ("Policy Statement")³ in December, 2010.

23 Together, the EE Rules and Policy Statement triggered a timely and appropriate shift
24 in the Commission's approach to utility regulation where the traditional model, which allows
25 utilities to recover their Commission-approved fixed costs based upon sales volumes, gives
26 way to a model that allows utilities to recover their Commission-approved fixed costs
27 irrespective of the volume sold. This shift in regulatory practice results in an instant
28 alignment of utility and customer interests, and the beginning of a valuable partnership

³ Ex. RUCO-1.

1 between the utility and its customers in the pursuit of increased energy savings and lower
2 customer bills.

3 Southwest Gas actively participated in proceedings that lead to these two new
4 policies, and takes very seriously the guidance and instruction provided by the Commission.
5 As the first Arizona utility seeking to implement the Commission directives set forth in both
6 the EE Rules and the Policy Statement, Southwest Gas included in its Application an
7 Energy Efficiency and Renewable Energy Resource Technology Portfolio Implementation
8 Plan ("EE/RET Plan")⁴ consistent with the EE Rules, as well as a full revenue decoupling
9 mechanism - the Energy Efficiency Enabling Provision ("EEP"). Although this was not the
10 Company's first request for decoupling, it was the first time the Company had direction from
11 the Commission, in the form of its Policy Statement, as to its preferred form of decoupling
12 and the specific provisions it would like to see in a decoupling proposal.

13 Southwest Gas also worked diligently and cooperatively with the other parties to this
14 docket, including the Arizona Corporation Commission Utilities Division Staff ("Staff"), the
15 Residential Utility Consumer Office ("RUCO"), the Southwest Energy Efficiency Project
16 ("SWEEP"), the Arizona Investment Council ("AIC"), the Natural Resources Defense Council
17 ("NRDC"), Tucson Electric Power Company ("TEP") and Cynthia Zwick (collectively,
18 "Parties"), to negotiate a proposed resolution to this matter. Consequently, the Settlement
19 Agreement is the result of open and transparent negotiations⁵, and reflects the intent of a
20 majority of the Parties to embrace and implement the Commission's EE Rules and Policy
21 Statement.

22 RUCO is the only Party that does not support the Settlement Agreement, primarily
23 due to the decoupling provisions contained therein⁶. Nonetheless, RUCO fails to provide an
24 appropriate alternative for decoupling, as directed by the Policy Statement.⁷ RUCO's
25 opposition to the Settlement Agreement is wholly unsupported and presents no reasonable
26 basis for denying approval of the carefully negotiated and well-reasoned Settlement

27 ⁴ Ex. A-2.

28 ⁵ Although RUCO refused to execute the Settlement Agreement, it participated in the settlement process and acknowledges that it was open and transparent. Tr. Vol.III (Jerich) at 687.

⁶ TEP did not execute the Settlement Agreement. However, TEP participated in the settlement negotiations and expressed its support for the Settlement Agreement.

⁷ Ex. RUCO-1 at 30.

1 Agreement that the other Parties have shown to be fair, just and reasonable, and in the
2 public interest.

3 II.

4 BACKGROUND AND PROCEDURAL HISTORY

5 Southwest Gas filed its Application November 12, 2010 and received its Letter of
6 Sufficiency December 13, 2010. Administrative Law Judge ("ALJ") Dwight D. Nodes issued
7 a Procedural Order January 7, 2011 adopting two procedural tracks; a standard track for a
8 litigated case and an expedited track in the event the Parties negotiated a settlement.

9 In addition to Staff and RUCO, TEP, SWEEP, AIC, NRDC and Cynthia Zwick were
10 granted the right to intervene in this proceeding. During the discovery process, Southwest
11 Gas organized two technical conferences related to its EEP proposal. Staff and certain
12 intervening Parties filed direct testimony on all issues except rate design June 10, 2011, and
13 direct rate design testimony was filed June 24, 2011. Southwest Gas filed Notice of
14 Settlement Discussions June 23, 2011, and the Parties engaged in several settlement
15 meetings beginning June 28, 2011, and concluding July 14, 2011. On July 15, 2011, Staff
16 filed the Settlement Agreement executed by Southwest Gas, Staff, SWEEP, AIC, NRDC and
17 Cynthia Zwick ("Settlement Parties"). The Settlement Parties filed testimony in support of
18 the Settlement Agreement on July 29, 2011. That same day, RUCO filed testimony
19 opposing the Settlement Agreement. A hearing on the Settlement Agreement was
20 conducted by ALJ Nodes on August 10, 2011, August 12, 2011 and August 15, 2011.

21 III.

22 OVERVIEW OF SETTLEMENT AGREEMENT

23 The predominant issue addressed in the Settlement Agreement is revenue
24 decoupling. The Settlement Parties agreed that revenue decoupling should be implemented
25 but sought to provide the Commission the opportunity to select the decoupling methodology
26 it prefers. Therefore, using the EE Rules and the Policy Statement as their guide, the
27 Settlement Parties crafted two decoupling proposals – Alternative A and Alternative B. Each
28 Alternative is accompanied by its own specific terms and provisions, which were carefully
designed by the Settlement Parties with the intent that the Commission will select one

Alternative in its entirety.⁸ For example, each Alternative ties to a specific revenue requirement, return on equity ("ROE") and fair value rate of return ("FVROR").⁹ However, under both Alternatives, the Company commits to working with Staff to develop a customer outreach and education plan regarding decoupling.¹⁰ Additionally, both Alternatives provide for an annual review of the applicable decoupling mechanism.¹¹ Each Settling Party, with the exception of Staff, was given the opportunity to voice its support for either of the two Alternatives.¹² Southwest Gas presented evidence supporting its preference for Alternative B.¹³

Perhaps even more unique than a Settlement Agreement with two distinct decoupling proposals, is the overwhelming consensus among the Settlement Parties that implementation of some form of decoupling is preferable to the current status quo.¹⁴ Accordingly, while most Settlement Parties expressed their preference for a particular Alternative, they agreed that if the Commission ultimately selects the Alternative they did not advocate for, they will nevertheless continue to support and abide by the Settlement Agreement.¹⁵

A. Alternative A.

Alternative A consists of a partial revenue decoupling mechanism, with two components; a weather component, which provides a "real-time" adjustment to customer bills when actual weather during the winter months differs from the average weather used to calculate rates, and a Lost Fixed Cost Recovery (LFCR) component, which allows the Company to recover lost base revenues tied to achievement of the energy savings set forth in the EE Rules.¹⁶ Under the LFCR, Southwest Gas collects its anticipated lost revenues assuming it achieves 100 percent of the required energy savings. If the Company fails to achieve 100 percent of the target savings, the difference between lost revenue calculated on

⁸ Ex. A-14 at 6-7.

⁹ *Id.* at 7, 9-10.

¹⁰ *Id.* at 9, 14.

¹¹ *Id.* at 8-9, 10, 13.

¹² *Id.* at 7.

¹³ Tr. Vol. I (Hester) at 80-83. See also, Ex. A-16 at 9-10.

¹⁴ Tr. Vol. I (Hester) at 97-98; Tr. Vol. I (Olea) at 222; Tr. Vol. II (Hansen) at 338; Tr. Vol. II (Cavanagh) at 379, 389; Tr. Vol. II (Schlegel) at 448.

¹⁵ Ex. A-14 at 6-7; 25.

¹⁶ Ex. A-14 at 7-9. See also, Ex. A-16 at 5.

1 100 percent savings and the actual lost revenue is refunded to customers. Similarly, if the
2 Company exceeds 100 percent energy savings, it will collect the difference from customers
3 the following year.¹⁷ If the Commission selects Alternative A, the initial LFCR surcharge will
4 be \$0.00213 per therm, based upon the 2011 energy savings targets provided in the EE
5 Rules.¹⁸ The revenue requirement associated with Alternative A is \$54,927,101, the ROE is
6 9.75%, and the FVROR is 7.02%.¹⁹

7 **B. Alternative B.**

8 Alternative B is a full revenue decoupling mechanism. Like Alternative A, it has a
9 "real-time" weather component. However, unlike Alternative A, Alternative B adjusts rates to
10 reflect any difference between the Company's non-gas authorized revenues per customer
11 and its actual non-gas revenues per customer, thereby completely eliminating the link
12 between revenues and consumption, and allowing the Company to freely partner with its
13 customers to achieve energy savings and lower utility bills.²⁰ This "true-up" will occur
14 annually.²¹ Alternative B also includes a 5% cap, so there is a limit to the amount that can
15 be collected by the Company each year through the surcharge, but there is no limit on the
16 dollars that can be refunded to customers.²² This cap will protect customers by not allowing
17 any true-up to exceed more than approximately \$1.40 per month, in any given year.²³ The
18 revenue requirement associated with Alternative B is \$52,607,414, the ROE is 9.50%, and
19 the FVROR is 6.92%.²⁴

20 **C. Southwest Gas' Preference for Alternative B.**

21 As discussed at length in the Company's testimony, it prefers Alternative B.²⁵ Not
22 only is full revenue decoupling the Commission's preferred methodology, it is the
23 mechanism that best effectuates the goals set forth in the EE Rules and the Policy
24 Statement.²⁶ Additionally, as several witnesses explained, the EE Rules allow 25% of a

25 ¹⁷ Id. at 7-8. See also, Ex. A-16 at 5-6.

26 ¹⁸ Id. at 8.

¹⁹ Id. at 7.

27 ²⁰ Id. at 9-10.

²¹ Id. at 10.

28 ²² Id. at 13-14.

²³ Tr. Vol. II (Hansen) at 263.

²⁴ Id. at 9-10.

²⁵ Tr. Vol. I (Hester) at 80-83. See also, Ex. A-16 at 9-10.

²⁶ Ex. RUCO-1 at 29.

1 utility's energy savings to be captured through efforts such as supporting energy efficient
2 building codes and appliance standards.²⁷ Southwest Gas has worked, and will continue to
3 work, on these types of efforts. However, because these savings are not directly tied to a
4 specific energy efficiency program, they will not be included in the LFCR mechanism, and
5 the Company's disincentive to promote and participate in these activities will therefore not
6 be completely eliminated.²⁸

7 It is also important to note that Alternative B has multiple benefits that go beyond
8 energy efficiency and conservation; some that the Settlement Parties included in the
9 Alternative B package with the intent of providing additional customer protections or
10 benefits, and others that are derived from the mechanism itself. These benefits include:

11 **Benefits Incorporated into Alternative B by Settlement Parties**

- 12 • Adjusting bills monthly to protect customers from an extreme weather event;
- 13 • A 5% cap on amounts collected through the surcharge;
- 14 • Annual earnings test to ensure the Company does not collect a surcharge if it will
15 over earn;²⁹
- 16 • A 5-year rate case moratorium that will provide bill stability to customers;³⁰
- 17 • Quarterly and annual reporting requirements;³¹
- 18 • Customer outreach and education.

19 **Benefits Inherent to the Full Revenue Decoupling Mechanism**

- 20 • Prevents the utility from increasing profits through increased sales;³²
- 21 • Provides refunds to customers when the utility over-collects;³³
- 22 • Enhanced bill stability through decreased frequency of rate cases and protection
23 from the vagaries of weather;³⁴
- 24 • Immediate customer savings of the commodity rate and permanent savings of
25 the gas cost component;³⁵

26 ²⁷ Ex. S-7 at 18-19; Tr. Vol. II (Schlegel) at 460-61, 479-81; Tr. Vol. III (Keene) at 529.

27 ²⁸ Tr. Vol. I (Hester) at 138; Tr. Vol. II (Hansen) at 285-86; Tr. Vol. II (Schlegel) at 465-66, 479-81.

28 ²⁹ Ex. A-14 at 12.

³⁰ Id. at 14.

³¹ Id. at 10-12.

³² Ex. A-16 at 9. See also, Tr. Vol II (Cavanagh) at 391, 396.

³³ Id. at 10. See also, Tr. Vol. I (Hester) at 97; Tr. Vol II (Schlegel) at 420.

³⁴ Id. See also, Tr. Vol. I (Hester) at 81; Tr. Vol. I (Olea) at 240; Tr. Vol II (Hansen) at 299-300.

- Cap on the amount of revenue per customer a utility can receive;³⁶
- Increases revenue stability, resulting in improved financial health and lower long-term debt costs, which in turn benefits customers through positive credit ratings and future debt cost reductions;³⁷
- Administratively simple - reduces the frequency of time-consuming and expensive rate cases;³⁸
- Mechanically simple – no lengthy or contentious hearings to determine the utility's actual lost revenues associated with its energy efficiency programs.³⁹

D. Other Settlement Provisions.

The record also clearly demonstrates the benefits of several other important provisions in the Settlement Agreement, which are indifferent to the decoupling mechanism the Commission ultimately selects. These provisions include:

- A Customer Owned Yard Line ("COYL") replacement program to assist customers in replacing their existing COYLs with Company-owned and maintained facilities;⁴⁰
- The commitment of \$1,000,000 of non-ratepayer funds to the Low Income Energy Conservation ("LIEC") weatherization program over the next 5 years;⁴¹
- An increase to the Low-Income Rate Assistance ("LIRA") discount, from 20% to 30%;⁴²
- An expense reduction plan, requiring the Company to reduce expenses on an annual basis by an average of \$2,500,000 per year, beginning in 2012;⁴³
- A modified EE/RET Plan that will incrementally improve the Company's current program offerings in terms of both budget and energy savings. The modified EE/RET Plan will achieve annual energy savings of 1,250,000 within 9 months of

³⁵ Id. See also, Tr. Vol I (Hester) at 83, 93-94, 134-37; Tr. Vol II (Hansen) at 280-81.

³⁶ Id. See also, Tr. Vol. I (Hester) at 139-40; Tr. Vol II (Hansen) at 348; Tr. Vol II (Cavanagh) at 390-91.

³⁷ Id. See also, Tr. Vol I (Hester) at 99; Tr. Vol. II (Yaquinto) at 506.

³⁸ Id. See also, Tr. Vol. I (Hester) at 110; Tr. Vol II (Hansen) at 306.

³⁹ Id. See also, Tr. Vol. I (Hester) at 109, 113; Tr. Vol. II (Hansen) at 307-09; Tr. Vol. II (Schlegel) at 435-36, 467.

⁴⁰ Ex. A-14 at 18-20.

⁴¹ Id. at 4, 15.

⁴² Id. at 15-16.

⁴³ Id. at 20.

Commission approval.⁴⁴ The Company will also make a separate filing in September 2011, requesting approval of its Revised EE/RET Plan, which will be designed to achieve annual energy savings equivalent to the first year savings target set forth in the EE Rules within 12 months of Commission approval;⁴⁵

- No increase to the residential basic service charge.⁴⁶

IV.

SOUTHWEST GAS' REQUEST FOR APPROVAL OF THE SETTLEMENT AGREEMENT

The Commission has the "full power to, and shall, prescribe just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected, by public service corporations within the state for service rendered therein".⁴⁷ Although the Commission's authority to prescribe rates for public utilities is plenary, it is subject to the "just and reasonable" clauses of Article 15, Section 3 of the Arizona Constitution.⁴⁸

Further, the United States Supreme Court, in *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia, et al.*,⁴⁹ held that rates that are not sufficient to yield a reasonable return on the value of property used in public service are unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility of its property in violation of the Fourteenth Amendment.⁵⁰ In a decision subsequent to *Bluefield*, the Court recognized that the fixing of just and reasonable rates involves a balancing of both investor and customer interests:

The investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for the operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock.⁵¹

⁴⁴ Id. at 17.

⁴⁵ Id. at 17-18.

⁴⁶ Id. at 5.

⁴⁷ Ariz. Const. art 15, §3.

⁴⁸ Residential Utility Consumer Office v. Arizona Corporation Commission, 199 Ariz. 588, 20 P.3d 1169 (Ariz.App. Div. 1 2001).
⁴⁹ 262 U.S. 679 (1923).

⁵⁰ Id. at 690.

⁵¹ Federal Power Commission et al v. Hope Natural Gas Co. City of Cleveland, 320 U.S. 591 (1944).

1 **A. The evidence clearly establishes that the Settlement Agreement is fair,**
2 **just and reasonable, and in the public interest, and that it should be**
3 **approved.**

4 As demonstrated in its Application, Southwest Gas requires a rate increase to
5 recover the costs of service necessary to provide safe and reliable service to its Arizona
6 customers. The need for a rate increase stems primarily from the continued decline in
7 residential and general service consumption per customer experienced by the Company
8 over the last several years, as well as changes to the Company's cost of capital.⁵² These
9 factors render the Company unable to meet the authorized return established in its last rate
10 case. In fact, Mr. Hester testified that Southwest Gas has not met its Commission-
11 authorized rate of return for at least 15 years.⁵³ Moreover, with the recent adoption of the
12 EE Rules it is undeniable that usage will decline even further; and that it will do so at an
13 accelerated pace as customers conserve more energy and become more energy efficient.⁵⁴

14 The Settlement Parties agreed on a revenue requirement, ROE and FVROR that
15 corresponds with each of the decoupling Alternatives, and they therefore believe that the
16 selection of either Alternative A or Alternative B in its entirety will result in rates, charges and
17 conditions of service that are just and reasonable and in the public interest.⁵⁵ Indeed, Mr.
18 Hester's testimony demonstrates that irrespective of which Alternative the Commission
19 selects, the resulting revenue increase and ROE will fall either within the range, or below the
20 range, of the increases and ROEs recommended by the Settlement Parties.⁵⁶ Moreover, the
21 resulting revenue increase in either Alternative A or Alternative B will be only slightly above
22 the \$47.6 million dollar increase offered by RUCO in its testimony opposing the Settlement
23 Agreement⁵⁷, and the 9.50% ROE associated with Alternative B is identical to the ROE
24 offered in RUCO's testimony opposing the Settlement Agreement.⁵⁸

25 Further proof that the Settlement Agreement is in the public interest is found in the
26 extensive customer benefits offered therein, some of which might not have been possible in

27 ⁵² Ex. A-1 at 4.

28 ⁵³ Tr. Vol. I (Hester) at 87, 97-98.

⁵⁴ Id. at 86, 98.

⁵⁵ Ex. A-14 at 14-15.

⁵⁶ Ex. A-16 at 10.

⁵⁷ Ex. RUCO-13.

⁵⁸ Ex. RUCO-12 at 2.

1 a litigated case. For example, implementation of a decoupling mechanism – particularly the
2 full revenue decoupling mechanism provided in Alternative B - aligns the Company's
3 interests with those of its customers, in order to pursue annual bill savings consistent with
4 the EE Rules.⁵⁹ But beyond that, revenue decoupling offers other important benefits. As
5 outlined above, the record effectively demonstrates that decoupling provides enhanced bill
6 stability, immediate customer savings on the commodity rate and permanent gas cost
7 savings, and revenue stability, which benefits customers through positive credit ratings and
8 future debt cost reductions.⁶⁰ Revenue decoupling also provides refunds to customers in
9 the event of an over-collection of authorized non-gas costs and, in this case, Alternative B
10 provides for an earnings test that will prevent Southwest Gas from collecting under the
11 decoupling surcharge if it will over-earn. Finally, revenue decoupling reduces the frequency
12 of expensive and time-consuming rate case proceedings and if the Commission selects
13 Alternative B, Southwest Gas will in fact be subject to a 5 year rate case moratorium.⁶¹

14 Additionally, as described above, the Company will implement a COYL replacement
15 program and an earnings reduction plan. It will also contribute shareholder dollars to the
16 LIEC weatherization program and increase the LIRA discount. The Company has also
17 provided a modified EE/RET Plan to incrementally enhance its existing customer savings
18 opportunities and will file a Revised EE/RET Plan consistent with the EE Rules. Further,
19 without an increase to the Company's residential basic service charges, bill savings
20 associated with increased energy efficiency and conservation will be enhanced – a benefit
21 that is reduced with RUCO's proposal.

22 Southwest Gas acknowledges the large number of emails and letters filed in this
23 docket, and appreciates the public's comments. However, despite RUCO's contentions,⁶²
24 the volume of correspondence should not be misconstrued as overwhelming customer
25 opposition to the Settlement Agreement, or even the decoupling proposals. First, many of
26 the emails and letters reference the \$73.2 million increase referenced in the Company's

27 ⁵⁹ Tr. Vol. I (Olea) at 243-44; Tr. Vol. II (Hansen) at 269; Tr. Vol. II (Cavanagh) at 364-65, 369-70, 383-84; Tr. Vol. II (Schlegel) at
28 421-25, 464-65;

⁶⁰ Tr. Vol. I (Hester) at 50, 139-41, 154-55; Tr. Vol. II (Hansen) at 354; Tr. Vol. II (Cavanagh) at 371-75, 390-91; Tr. Vol. II
(Yaquinto) at 507-08

⁶¹ Ex. A-14 at 5.

⁶² Tr. Vol. III (Jerich) at 771-72.

1 Application and although the Company does not believe that request to be unnecessary or
2 unreasonable, the settlement process lead to agreement on a lower revenue requirement
3 (\$54.9 million under Alternative A or \$52.6 million under Alternative B).

4 Second, Southwest Gas and the other Settlement Parties paid very close attention to
5 comments made during the Commission's decoupling workshops, as well as statements
6 issued by local and national organizations, and carefully considered them when crafting the
7 Settlement Agreement. For example, Mr. Hester aptly explained that the Settlement Parties
8 took each of the points mentioned in the literature published by the national AARP into
9 account when designing the decoupling proposals.⁶³ And in examining not just the number
10 of correspondence, but the content, this effort can be deemed a success. Southwest Gas
11 estimates that of the approximately 2,000 emails and letters received by the Commission
12 through August 9, 2011, less than 2% reference decoupling.⁶⁴ This is not to say, however,
13 that Southwest Gas' job is done. The Company recognizes that there are lingering
14 misunderstandings about decoupling and how it works, which is why the Settlement
15 Agreement contains provisions requiring the Company to work with Staff to develop
16 customer education and outreach materials related to decoupling.⁶⁵

17 **B. Decoupling is not prohibited by the Arizona Constitution.**

18 One of the questions raised during the hearing was whether approval of a decoupling
19 mechanism runs afoul of the requirement under the Arizona Constitution that the
20 Commission set rates based upon the fair value of the utility's Arizona property.⁶⁶
21 Southwest Gas submits that it does not.

22 The Arizona Constitution requires the Commission to ascertain the value of a utility's
23 property within the state in order to set just and reasonable rates.⁶⁷ Although there is no
24 constitutionally-established formula for doing so, the Commission must determine the fair
25

26 ⁶³ Tr. Vol. I (Hester) at 74-77.

27 ⁶⁴ The docket does not show each of the emails and letters received by the Commissioners. However, many Commissioners
28 provided examples of the correspondence they received and it was also made clear during the public comment session that many
of the emails and letters generated from a form correspondence drafted by Arizona's local AARP chapter. Tr. Vol. I (Jennings) at
18. That correspondence makes no reference to decoupling.

⁶⁵ Ex. A-14 at 9, 14.

⁶⁶ Tr. Vol. III (Johnson) at 664-65.

⁶⁷ Ariz. Const. art 15, §14.

1 value of the utility's property and use that determination in formulating rates.⁶⁸ Therefore,
2 the Commission is without authority to increase a rate without first considering the utility's
3 rate base and the overall impact of the increase on the utility's return.⁶⁹ Arizona courts have
4 carved out an exception to this rule for automatic adjustment clauses which are,

5 ...generally established by the Commission as part of a utility's overall rate
6 structure. It is usually established during a full rate hearing to allow a utility to
7 increase or decrease rates automatically, 'in relation to fluctuation in certain
8 narrowly defined, operating expenses.' Automatic adjustment clauses are
9 designed to ensure that utilities maintain a relatively consistent profit despite an
increase in a specific cost anticipated by the adjustment clause...In essence,
an automatic adjustment clause is designed to offset cost increases and
decreases, leaving the utility's ultimate net income unchanged.⁷⁰

10 Dr. Johnson implies that the decoupling proposals in the Settlement Agreement
11 might not pass Constitutional muster because they amount to automatic adjustments that
12 allow the Company's return on fair value to fluctuate over time.⁷¹ However, that is simply
13 not the case. Mechanically, decoupling is not an automatic adjustment clause, as defined
14 by Arizona law. Automatic adjustment clauses have been defined as mechanisms that track
15 specific costs and then adjust to reflect market fluctuations in those costs to offset any cost
16 increases and decreases following a rate case. To the contrary, decoupling mechanisms
17 simply true-up any differences between any under or over recovery of Commission-
18 approved fixed costs – regardless of market fluctuations in those costs, to ensure the utility
19 recovers no more and no less than what the Commission authorized in this rate case.

20 Even if the Commission determines that Arizona's definition of "adjustment clause"
21 extends beyond specific cost adjustments to include adjustments to rates to allow
22 Southwest Gas to recover its Commission approved costs, the decoupling provisions set
23 forth in Alternatives A and B remain compliant with Arizona law. Under *Scates* and the
24 decisions that followed, it is clear that a valid adjustment clause must derive from a general
25 rate case proceeding and be adopted as part of the utility's rate structure.⁷² Further, the

26
27 ⁶⁸ *Scates v. Arizona Corporation Commission*, 118 Ariz. 531, 534, 578 P.2d 612, 615 (Ariz.App. Div. 1 1978); *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 151, 294 P.2d 378, 382 (1956); *Residential Consumer Utility Office v. Arizona Corporation Commission*, 199 Ariz. 588, 591, 20 P.3d 1169, 1172 (Ariz.App. Div. 1 2001).

28 ⁶⁹ *Scates*, 118 Ariz. 531 at 534.

⁷⁰ *RUCO v. ACC*, 199 Ariz. 588 at 591, *citing*, *Scates*, 118 Ariz. 531 at 535.

⁷¹ *Tr. Vol. III (Johnson)* at 664-65.

⁷² 118 Ariz. 531 at 535. See also, *RUCO v. ACC*, 199 Ariz. 588 at 591.

1 adjustment clause must ensure that the utility's authorized rate of return does not change on
2 account of the fluctuations in consumption that the decoupling mechanisms in this case are
3 tied to.⁷³

4 Here, there is no dispute that regardless of which Alternative the Commission
5 selects, the decoupling mechanism will stem from a general rate case and constitute a
6 portion of Southwest Gas' rate structure. Indeed both Alternatives are designed such that
7 the Company will only recover the costs that are reviewed and approved by the Commission
8 as part of this general rate case. No additional costs beyond those that are being approved
9 as part of this rate case will be recovered through either decoupling Alternative. Similarly,
10 the Company's Commission authorized rate base and FVROR will remain exactly the same,
11 and they will not fluctuate between rates cases as was incorrectly suggested by Dr.
12 Johnson. The authorized FVROR it will remain at either 7.02% or 6.92%, depending on
13 which Alternative the Commission selects.

14 Additionally, neither Alternative results in unconstitutional rate changes because both
15 are based upon determining the approved fixed cost recovery that was contemplated when
16 the Commission makes its determination of fair value during the rate case, and which were
17 in fact contemplated in this case. Under Alternative A, the decoupling mechanism is tied to
18 the fixed costs lost by the Company due to increased energy efficiency. If the Company
19 achieves more or less than 100% of its target energy savings, the mechanism works to
20 either collect or refund the difference. With respect to Alternative B, the very essence of the
21 mechanism is that the annual "true-up" either collects dollars or refunds dollars such that the
22 Company recovers no more or no less than the revenue per customer authorized by the
23 Commission; and the authorized revenue per customer will not change until the Company's
24 next general rate case. The annual interim adjustments are used only to effectuate the
25 over-collection or under-collection of fixed costs experienced in the prior year. As such, the
26 Commission's approval of the Settlement Agreement will in no way violate its Constitutional
27 obligations.

28

⁷³ Id.

1 On the other hand, the evidence in this case could provide the back-drop for a legal
2 challenge in the event the Commission refuses to approve either of the decoupling
3 mechanisms proposed in the Settlement Agreement. Scates very clearly states, "[T]he rates
4 established by the Commission should meet the overall operating costs of the utility and
5 produce a reasonable rate of return."⁷⁴ In light of the substantial evidence offered by
6 Southwest Gas regarding its chronic decline in consumption per customer, the EE Rules'
7 mandate for continued reductions in customer consumption, and the Company's inability to
8 earn the authorized rate of return in its last rate case, and for at least a decade prior to that,
9 the Company has undeniably established a need for decoupling. Accordingly, a decision
10 that denies decoupling altogether could be deemed a failure on the Commission's part to set
11 rates sufficient to meet the Company's operating costs and produce a reasonable rate of
12 return.

13 V.

14 RUCO'S OPPOSITION TO THE SETTLEMENT AGREEMENT

15 RUCO concedes that there are many benefits to the Settlement Agreement, and that
16 it in fact supports many aspects of the Settlement Agreement.⁷⁵ Indeed, RUCO's opposition
17 rests solely on three criticisms - the methodology for calculating FVROR, the use of a 10-
18 year weather normalization model, and the inclusion of decoupling proposals. In support of
19 its objections, RUCO relied heavily on the testimony of Dr. Johnson; a witness who, prior to
20 this case, never testified in a proceeding regarding revenue decoupling for a gas distribution
21 company, nor was ever retained to review the effectiveness of a revenue decoupling
22 mechanism for a gas distribution company.⁷⁶ Even on the issues with which Dr. Johnson is
23 familiar, his testimony proves erroneous and inconsistent. Further, RUCO's limited
24 participation in the decoupling workshops and its failure to respond to the Commission
25 directives set forth in the Policy Statement are readily apparent throughout its arguments
26 against the decoupling proposals, and in its failed attempt to provide an acceptable
27

28 ⁷⁴ 118 Ariz. 531 at 534.

⁷⁵ Tr. Vol. III (Jerich) at 687-88.

⁷⁶ Tr. Vol. III (Johnson) at 598.

1 alternative to decoupling in this case. As such, RUCO's entire opposition to the Settlement
2 Agreement rings hollow and should be rejected by the Commission.

3 **A. The evidence clearly demonstrates that RUCO's objections to the**
4 **Settlement Agreement are without merit.**

5 As demonstrated at the hearing and highlighted below, each of RUCO's objections to
6 the Settlement Agreement are squarely rebutted by the testimony and evidence in the
7 record, leaving RUCO with no meaningful evidence to establish that the Settlement
8 Agreement is unfair, unjust, unreasonable, or not in the public interest.

9 **1. FVROR.**

10 Dr. Johnson initially took the position that the FVROR utilized in the Settlement
11 Agreement (which was one of two FVROR calculations originally proposed by Staff) was not
12 as theoretically sound as his own methodology, and he emphatically stated that the
13 components of the Staff's methodology could "...blow up in the face [of the Commission] a
14 few years from now...or in the face of customers ten years from now."⁷⁷ In response, Mr.
15 Hester again provided uncontroverted testimony demonstrating the reasonableness of
16 Staff's methodology, as it is in fact the same methodology approved by the Commission in
17 Southwest Gas' last general rate case.⁷⁸ In fact, Dr. Johnson himself confirmed that this
18 methodology was adopted by the Commission on at least one other occasion.⁷⁹ Most
19 significant, however, is Dr. Johnson's subsequent testimony, where he acknowledged a
20 substantial error in his initial comments, and confirmed as follows:

21 [M]y testimony where I was describing the potential for this methodology of kind
22 of going off the rails and blowing up in the Commission's face in the event of
23 rapid inflation **was simply wrong**. [Staff's] methodology **is not as unstable as**
24 **I was thinking** since it is an attempt to tie it to a real risk-free rate of return,
25 which would be a much more stable concept. (emphasis added)⁸⁰

26 Accordingly, the methodology for calculating the FVROR calculation in the Settlement
27 Agreement is sound and RUCO's FVROR objection has been effectively disproven by its
28 own witness.

⁷⁷ Id. at 626.

⁷⁸ Tr. Vol. I (Hester) at 79.

⁷⁹ Tr. Vol. III (Johnson) at 624.

⁸⁰ Id. at 775-76.

1 **2. Weather Normalization.**

2 In RUCO's second attempt to attack the Settlement Agreement, Dr. Johnson opines
3 that the Company, and ultimately the Settlement Parties, inappropriately calculated the
4 proposed revenue requirements by including adjustments to non-gas revenues based upon
5 average "normal" weather conditions over a 10 year period,⁸¹ and insists that a 30-year
6 average should be used instead.⁸² Despite accurately recalling that Staff's FVROR
7 methodology had been approved by the Commission on at least one other occasion, Dr.
8 Johnson conveniently overlooks the fact that the Commission routinely approves revenue
9 requirement figures that are calculated using 10-year weather normalization models. Indeed,
10 Mr. Hester provided undisputed testimony that the Company has used, and the Commission
11 has approved, a 10-year weather normalization calculation since at least the early 1990's.⁸³
12 Accordingly, the 10-year normalization is a long-standing and sound methodology, and the
13 Settlement Parties did not act unreasonably in utilizing it to calculate the revenue
14 requirements presented in the Settlement Agreement.

15 **3. Decoupling.**

16 RUCO objects to the decoupling proposals contained in the Settlement Agreement
17 on various grounds. However, testimony from RUCO's own witnesses confirms that its
18 reasoning is fraught with misstatements, misinformation and obvious contradiction.

19 First, Dr. Johnson disingenuously argues that decoupling is a "highly controversial
20 issue",⁸⁴ representing "risky and uncharted waters" for the Commission to navigate.⁸⁵
21 There is absolutely no question, and certainly no evidence in the record to suggest that the
22 Commission did not undertake a thorough and complete investigation and evaluation of
23 decoupling. In fact, the record is overflowing with evidence to the contrary,⁸⁶ including the
24 Commission's own Policy Statement and the following testimony from Mr. Cavanagh:

25 I do not recall a more thorough evaluation of the alternatives, of the skeptical
26 arguments, a more thorough financial analysis, commissioned by one of the

27 ⁸¹ Ex. RUCO-10 at 13-15.

⁸² Id.

⁸³ Tr. Vol. I (Hester) at 79-80.

⁸⁴ Ex. RUCO-10 at 3.

⁸⁵ Id. at 6.

⁸⁶ Tr. Vol. I (Hester) at 140-41; Tr. Vol. I (Olea) at 171, 210; Tr. Vol. II (Cavanagh) at 360-61, 365-67, 383-84, Tr. Vol. II (Schlegel) at 424-25, 428, 434.

1 nation's top federal research laboratories, the engagement of the Regulatory
2 Assistance Project, which is the gold standard for regulatory experience, and at
3 a time when we had the record of 22 states with natural gas decoupling and 12
4 with electric decoupling to draw upon. If after all of that someone thinks we
5 need more study...I fear they will never be satisfied.⁸⁷

6 Dr. Johnson also claims that decoupling will not encourage energy efficiency, and
7 may actually end up "discouraging customers from conserving energy".⁸⁸ This allegation
8 was handily contradicted by all of the Settlement Parties,⁸⁹ especially in relation to RUCO's
9 own proposal for increasing the basic service charge. Mr. Schlegel stated that, "...raising a
10 basic service charge is a much more impactful disincentive to efficiency than decoupling
11 could ever be. And under decoupling there is still a significant incentive to conserve."⁹⁰
12 Indeed, as established below, both Dr. Johnson and RUCO director Jodi Jerich testified that
13 RUCO's own proposal of increasing the basic service charge discourages conservation.⁹¹

14 Similarly, Dr. Johnson contends that decoupling will force customers to pay higher
15 rates.⁹² This allegation was also effectively rebutted by the Settlement Parties,⁹³ but Dr.
16 Johnson's own testimony provides the most convincing proof that his claim is entirely
17 unverified and wholly unreliable. Dr. Johnson has never before testified regarding revenue
18 decoupling for a natural gas distribution company, and has never before been retained to
19 review the effectiveness of a decoupling mechanism for a natural gas distribution
20 company.⁹⁴ Most significantly, and despite his admitted lack of experience, **Dr. Johnson**
21 **never performed an analysis of the rate-per-therm impact of decoupling in this case,**
22 choosing instead to rely solely on his "intuitive sense of the numbers" to reach his
23 conclusions.⁹⁵

24 Dr. Johnson further testified that there is no evidence to demonstrate that
25 disincentives to promoting energy efficiency are influencing the Company's behavior, and no

26 ⁸⁷ Tr. Vol. II (Cavanagh) at 370-71.

27 ⁸⁸ Ex. RUCO-10 at 6.

28 ⁸⁹ Tr. Vol. I (Hester) at 82-83, 133, 153; Tr. Vol. I (Olea) at 192, 221; Tr. Vol. II (Hansen) at 265-66, 280-82, Tr. Vol. II (Cavanagh) at 375-76; Tr. Vol. II (Schlegel) at 432-33.

⁹⁰ Tr. Vol. II (Schlegel) at 431.

⁹¹ Tr. Vol. III (Johnson) at 592-93; Tr. Vol. III (Jerich) at 742.

⁹² Ex. RUCO-10 at 8. See also, Tr. Vol. III (Johnson) at 556.

⁹³ Tr. Vol. I (Hester) at 89, 93-94, 136-37; Tr. Vol. I (Olea) at 176, 202; Tr. Vol. II (Hansen) at 274-75, 284-85, 299-300; Tr. Vol. II (Cavanagh) at 401-06; Tr. Vol. II (Schlegel) at 425-26.

⁹⁴ Tr. Vol. II (Johnson) at 598.

⁹⁵ Id. at 594-95.

1 evidence that the impacts from the utility disincentives, "...justify a complex, risky overhaul
2 of the entire regulatory schema."⁹⁶ RUCO director Jodi Jerich provided conflicting
3 testimony, conceding that financial disincentives exist under the current regulatory model.⁹⁷
4 Yet RUCO persists in its claim that the Settlement Agreement should not be approved
5 because the Company failed to show that its requested rate increase is due primarily to lost
6 revenues in per customer gas consumption, and because there is no evidence indicating the
7 Company is unwilling to promote energy efficiency.⁹⁸ Although Dr. Johnson did not attend
8 any of the decoupling workshops, and Ms. Jerich stated that RUCO was present at "some,
9 but not all" of them⁹⁹, the Commission's shift in regulatory policy did not occur overnight, and
10 it certainly did not occur behind RUCO's back. The Policy Statement is built upon the
11 Commission's finding that Arizona utilities face financial disincentives to promoting energy
12 efficiency.¹⁰⁰ Thus, despite RUCO's contention, the Policy Statement does not require a
13 utility to demonstrate an inability to promote efficiency before implementing a decoupling
14 mechanism. Rather, it requires that the utility demonstrate the most effective means of
15 eliminating the disincentives that have already been proven to exist, which is exactly what
16 Southwest Gas and the other Settlement Parties have accomplished in this case.
17 Notwithstanding, there is ample evidence in the record to demonstrate that Southwest Gas
18 is in fact hampered by financial disincentives to energy efficiency, including Mr. Schlegel's
19 testimony that the Company, "...definitely has a disincentive to promote energy efficiency,
20 as well as an incentive to promote more gas use..."¹⁰¹

21 RUCO also argues that the decoupling provisions in the Settlement Agreement are
22 problematic because they purely benefit Southwest Gas, while providing no benefits to
23 customers.¹⁰² First, just as the Policy Statement reflects the Commission's finding that
24 utilities face financial disincentives to promoting energy efficiency it also reflects the
25 Commission's finding that customers will fundamentally benefit from a regulatory model that

26 ⁹⁶ Ex. RUCO-10 at 7.

27 ⁹⁷ Tr. Vol. III (Jerich) at 716-17.

28 ⁹⁸ Id. at 689-91.

⁹⁹ Id. at 718.

¹⁰⁰ Ex. RUCO-1 at 2, 4, 27, 30.

¹⁰¹ Tr. Vol. II (Schlegel) at 433. See also, Tr. Vol. I (Hester) at 86-87, 107-08, 137-41; Tr. Vol. I (Olea) at 243-44; Tr. Vol. II (Hansen) at 269-70, 285-86, 296-98, 307-09, 313-14, 321-22; Tr. Vol. II (Cavanagh) at 364-65, 374-75, 383-84.

¹⁰² Ex. RUCO-14 at 8.

1 removes those financial disincentives.¹⁰³ Second, there is no dispute that customers benefit
2 from immediate, “real-time” adjustments to their monthly gas bills when winter weather is
3 colder than normal. Third, contrary to Ms. Jerich’s assertion, customer protections are in
4 fact benefits,¹⁰⁴ especially when they are the product of settlement negotiations and would
5 likely not appear in a decision from a litigated case. As detailed above, the 5% cap, rate
6 case moratorium, earnings test, commitment to customer education, and routine
7 Commission oversight are all customer benefits associated with the decoupling mechanism
8 proposed in Alternative B.¹⁰⁵ In fact, Dr. Hansen and Mr. Cavanagh both testified that
9 Alternative B offers greater customer protections than the decoupling mechanisms they
10 have seen in other jurisdictions.¹⁰⁶ The Settlement Parties also clearly established the other
11 customer benefits associated with Alternative B, such as revenue stability and less frequent
12 rate cases.

13 In presenting RUCO’s other criticisms of decoupling, Ms. Jerich testified that it is the
14 wrong time for Southwest Gas to pursue decoupling because, given the current state of the
15 economy, it is “not appropriate to shift all risk from the ratepayer to the utility”.¹⁰⁷ However,
16 the record clearly establishes that decoupling does not create such a shift.¹⁰⁸ Moreover,
17 RUCO presented no evidence to dispute that the Settlement Agreement takes any
18 purported reduction in Southwest Gas’ risk into account by applying a 25 basis point
19 reduction in ROE to Alternative B.¹⁰⁹

20 RUCO also claims that the Company has not demonstrated a need for decoupling
21 because the primary reason for decoupling is to delay building utility infrastructure, which
22 does not apply to gas utilities like Southwest Gas.¹¹⁰ The fallacy of this argument is best
23 demonstrated by the Policy Statement itself which states, “Revenue decoupling achieves
24 the primary purpose of reducing utility disincentives to implementing demand side

25 ¹⁰³ Ex. RUCO-1 at 1, 2, 26, 29, 30.

26 ¹⁰⁴ Tr. Vol III (Jerich) at 731.

27 ¹⁰⁵ Tr. Vol. I (Hester) at 80-82; Tr. Vol. I (Olea) at 234-37, 241-42; Tr. Vol. II (Schlegel) at 418-21; Tr. Vol. II (Yaquinto) at 504-06.
28 See also, Ex. S-9 at 19-20.

¹⁰⁶ Tr. Vol. II (Hansen) at 354-55; Tr. Vol. II (Cavanagh) at 377.

¹⁰⁷ Tr. Vol. III (Jerich) at 688.

¹⁰⁸ Tr. Vol. I (Hester) at 148-49, 155; Tr. Vol. I (Olea) at 201-02; Tr. Vol. II (Hansen) at 353-54; Tr. Vol. II (Cavanagh) at 381-82,
398; Tr. Vol II (Yaquinto) at 503-04, 508.

¹⁰⁹ Ex. A-14 at 15. See also, Tr. Vol. I (Hester) at 75; Tr. Vol. II (Cavanagh) at 400-01.

¹¹⁰ Tr. Vol. III (Jerich) 692, 737.

1 management programs and reducing energy consumption.”¹¹¹ In addition, the record
2 reflects that while RUCO’s claim may hold true for electric utilities, it is not a paramount
3 concern for gas utilities.¹¹² Instead, gas utility customers receive an immediate and
4 permanent benefit through decoupling in that they immediately save on the commodity rate,
5 and will permanently save that gas cost portion of the commodity rate.

6 Finally, Ms. Jerich contends that Southwest Gas is not deserving of decoupling
7 because it is financially healthy.¹¹³ This argument is based on the faulty premise that
8 decoupling is only appropriate for risky utilities with poor credit metrics. This is obviously not
9 the Commission’s approach to decoupling, as the Policy Statement makes very clear that its
10 purpose for implementing decoupling is to encourage conservation through demand side
11 management programs and enable all Arizona utilities to meet the energy savings standards
12 prescribed by the EE Rules – not to cherry pick amongst them to determine which
13 companies could use a boost to their financial health. Further, although Southwest Gas has
14 recently received upgraded credit ratings, those upgrades were based at least in part, on the
15 Company’s request for full revenue decoupling in this case. And, as explained above, even
16 if the Company achieves full revenue decoupling, it is still subject to risk in terms of how it
17 manages its costs.¹¹⁴ There is also no dispute that Southwest Gas has not attained its
18 authorized rate of return in recent years.

19 It is abundantly clear that RUCO’s approach to this case is to simply throw at the
20 Commission every possible argument against decoupling and see if anything sticks;
21 notwithstanding Ms. Jerich’s confirmation that RUCO’s opposition is not based upon any
22 concerns that were not already addressed during the decoupling workshops.¹¹⁵ Indeed, Ms.
23 Jerich offered testimony during the workshops as to the 4 specific requirements RUCO
24 would need to see in a decoupling proposal in order to support it – cost-effectiveness, a
25 commitment to energy efficiency with identified goals, a high degree of accountability, and a
26

111 Ex. RUCO-1 at 4.

112 Tr. Vol. I (Hester) at 83, 134-35, 137; Tr. Vol. II (Hansen) at 266-67, 320-21; Tr. Vol. II (Cavanagh) at 402-03; Tr. Vol II (Schlegel) at 472-73

113 Tr. Vol. III (Jerich) at 693.

114 Tr. Vol. I (Hester) at 148-49, 155; Tr. Vol. I (Olea) at 201-02; Tr. Vol. II (Hansen) at 353-54; Tr. Vol. II (Cavanagh) at 396-98; Tr. Vol II (Yaquinto) at 503-04, 508.

115 Tr. Vol. III (Jerich) at 718-19.

cap on amounts that will be recovered.¹¹⁶ And notably, Ms. Jerich readily admitted that each of these conditions is satisfied under the Settlement Agreement.¹¹⁷

B. RUCO fails to provide an alternative to decoupling.

RUCO purports to have complied with the provisions of the Policy Statement that allow the Commission to consider alternatives to decoupling.¹¹⁸ RUCO's first alternative was a weather adjustment, presented in the Direct Testimony of Dr. Johnson.¹¹⁹ However, Dr. Johnson is clear that RUCO never whole-heartedly supported its weather proposal. He testified, "...we are certainly not enthused about either the weather decoupling or the per-customer decoupling"¹²⁰, and when asked if RUCO made its weather proposal in response to the Policy Statement he stated:

To the extent the policy statement asked parties not to be negative and also indicate an area of – a comfort zone or willingness to offer something, this was as far as RUCO was willing to go. The problem is, of course, we don't believe decoupling is the right thing to do, and any attempt to put forward a decoupling proposal runs the risk of...being characterized, 'Well, RUCO is for decoupling also.'¹²¹

Indeed, when it realized that the Settlement Parties included a weather component in both decoupling proposals, RUCO abandoned its initial position and now advocates for increasing the basic service charge from \$10.70 to \$11.85.¹²²

RUCO's unavoidable dilemma, however, is that the Policy Statement does not simply allow for **any** alternative proposals; nor does it, as Dr. Johnson suggests, seek a "comfort zone". The Policy Statement specifically allows for "...alternative methods for addressing utility financial disincentives...which encourage and enable aggressive use of demand side management programs and the achievement of Arizona's Electric and Gas Energy Efficiency Standards."¹²³ The blatant flaws in RUCO's proposal are acknowledged by its own witnesses. Dr. Johnson concedes that low-volume customers will pay a higher average rate per therm than high-volume users under RUCO's proposal, and he readily admits that,

¹¹⁶ Ex. A-17.

¹¹⁷ Tr. Vol. III (Jerich) at 726-28.

¹¹⁸ Ex. RUCO-1 at 30.

¹¹⁹ Ex. RUCO-7 at 26-27.

¹²⁰ Tr. Vol. III (Johnson) at 590.

¹²¹ Id. at 589-90.

¹²² Ex. RUCO-10 at 18.

¹²³ Ex. RUCO-1 at 30.

1 "[a]s you lower the fixed monthly charge, you increase the incentives for individual
2 customers to conserve. As you raise it, you lower their incentives to conserve."¹²⁴ Ms.
3 Jerich also testified that increasing the basic service charge discourages energy efficiency
4 and conservation, and in fact admitted that she did not know what percentage of the
5 Company's fixed costs would be recovered under RUCO's proposal, nor what the amount of
6 basic service charge would need to be in order to decouple Southwest Gas' revenues from
7 its sales.¹²⁵ Moreover, testimony from the Settlement Parties,¹²⁶ Dr. Hansen and Mr.
8 Cavanagh in particular, shows how just badly RUCO's proposal misses the mark:

9 By my calculation, the customer charge would need to be in excess of \$28 per
10 month in order for all non-gas costs to be recovered through the customer
11 charge. And that's the point at which we reach...straight fixed variable rates,
12 which is an alternative to decoupling mechanisms...that also removes the
13 utility's disincentive to conserve. So what RUCO has proposed is to move up
14 [\$1.15], when to solve the problem, they need to be moving up by \$16 or \$17.
15 So, at this rate of change you wouldn't solve the utility's incentive problem with
16 respect to conservation. For 15 more rate cases, at a rate of one every three
17 years, that's about 45 years until we have got this problem taken care of.¹²⁷

18 ...

19 [F]or me, the crucial, unfortunate thing about [RUCO's] proposal is that by
20 putting more of the customer's bill in a fixed charge and less in the variable
21 charge, you are reducing every customer's award for saving energy, at a time
22 when this Commission is rightly pressing for more progress on energy
23 efficiency...the Commission was very clear that it wanted to see rate designs
24 that were supportive of energy efficiency, not rate designs that constrained or
25 reduced it.¹²⁸

26 VI.

27 CONCLUSION

28 The evidence presented by Southwest Gas undoubtedly demonstrates its need for a
rate increase, such that it can continue to provide safe and reliable service to its Arizona
customers. Additionally, the Company and the other Settlement Parties presented evidence
which clearly shows that the Settlement Agreement is a fair, just and reasonable
compromise of the contested issues in this case, and which overwhelmingly supports the

¹²⁴ Tr. Vol. III (Johnson) at 592-93.

¹²⁵ Tr. Vol. III (Jerich) at 741-42,

¹²⁶ Tr. Vol. I (Olea) at 176; Tr. Vol. II (Cavanagh) at 410.

¹²⁷ Tr. Vol. II (Hansen) at 270.

¹²⁸ Tr. Vol. II (Cavanagh) at 364.

1 decoupling proposals outlined in the Settlement Agreement - both of which reflect the solid
2 foundation for decoupling established in the Commission's EE Rules and Policy Statement.

3 RUCO's primary opposition to the Settlement Agreement stems from its
4 unwillingness to support decoupling, but that unwillingness is not a sufficient basis for
5 rejecting the Settlement Agreement and thwarting implementation of the regulatory model
6 that the Commission has thoroughly examined and approved. The Commission's view was
7 perhaps most precisely articulated during the decoupling workshops, when then-
8 Commissioner Pierce stated, "decoupling is the standard – prove something else".¹²⁹ RUCO
9 failed to do so in this case.

10 For the foregoing reasons, Southwest Gas respectfully requests that the presiding
11 ALJ issue a Recommended Opinion and Order that finds, concludes and orders that the
12 Settlement Agreement is in the public interest and should be approved in its entirety,
13 inclusive of Alternative B; that the rates and charges set forth in the Settlement Agreement
14 provide a just and reasonable resolution to the issues raised in the Company's Application,
15 and are supported by evidence in the record¹³⁰; and that new rates should take effect
16 January 1, 2012.

17 Respectfully submitted this 2nd day of September, 2011.

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¹²⁹ Ex. A-18.

¹³⁰ Additional evidence supporting the rates and charges is found in Ex. A-14 and Ex. A-15.

ORIGINAL AND 13 COPIES of the foregoing
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